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Ensuring MSP for farmers through 'put options'

A WIN-WIN. While farmers are guaranteed MSP even if prices fall below the support level, for the Centre it will be a less expensive option

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With farmers in parts of northern India protesting, the Government is under pressure to provide a legal guarantee for minimum support prices (MSP) for crops. It is one of the trickiest issues among the charter of demands put forth by farmers, who concede that the issue has not found a solution in the past 75 years.

Without looking into the merits or demerits of this demand, it is pertinent to look at what will happen if the legal guarantee is provided for MSP. One, it will lead to more disputes between farmers and traders, resulting in cases with the police and courts piling up.

Two, traders could refuse to buy produce from farmers in places where guarantees are in place. Punjab passed laws to guarantee MSP but that was that. Nothing was heard thereafter, while a section of the trade said they would refrain from purchasing in the northern State.

Third, India could fall foul of the World Trade Organisation with its MSP procurement already under scrutiny. The Congress and other Opposition parties have jumped into the fray to say they will guarantee. But the issue is they haven't even attempted it in the States they rule.

Be that as it may, there can be a way out provided the Government, officials, farmers and their leaders look at other ways to try and ensure farmers across the country get MSP for the 22 crops that the Centre announces every year.

A WAY FORWARD

The way out could be getting farmers to go in for "put options" trading — something that has been said in these columns before by Madan Sabnavis (http://tinyurl.com/FarmersTrading Options). NCDEX MD and CEO Arun Raste has been batting for farmers taking part in put options trade to supplement the Centre's efforts to ensure MSP for farmers. Probably, farmers can enter "put options" at the MSP fixed by the Centre for the crop they produce.

This method can be used by the Centre to even ask procurement agencies such as the Food Corporation of India to buy for the central pool. And it is here, the Centre gets to ensure MSP, while at the same time could find ways to cut down its expenses on procurement for the central pool.

A participant in "put options" trading has to only pay an upfront charge or premium of 4-5 per cent. Farmers are chary of taking part in "put options" trading as they are yet to be convinced about futures trading. It is here that the Centre can look at NCDEX's pilot project in which it helped 41 farmer producer organisations (FPOs) to take part in "put options" trade with the aid of SEBI. After the project ended, a few FPOs are now trading in "put options" on their own.

Raste's argument for "put options" strategy is that it can be a good insurance against the MSP for crops as there is no price insurance for the growers. Farmers lose nothing by taking part in "put options" as they need not sell their produce below MSP. Also, if prices rise above MSP, they can come out of the "put options" by foregoing the margin money they pay and sell at a higher price.

BOOSTING PARTICIPATION

One way governments can get farmers to take part in this trading is by helping or funding FPOs to do it on behalf of the farmers. The "put options" binds the buyer who "strikes" and not the seller. Therefore, farmers are guaranteed the MSP even if prices fall below the support level.

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Kiran Devi, a women farmer from a Bihar village representing non-governmental organisation Jeevika, had explained the concept to budding civil servants at the Lal Bahadur Shastri National Academy of Administration a year ago. Devi has not been educated much but the point is if she can understand, so too can others.

Nabard, Maharashtra and Andhra Pradesh are seriously examining the issue of initiating farmers or FPOs in "put options" trading. The Centre would do well to take note of this and probably examine its feasibility.

What the Centre has to do here is to subsidise the margin payment for the "put options" as was done in the NCDEX pilot by SEBI.

At the same time, asking procurement agencies to enter "strike" options to procure grains to ensure buffer stocks purchase target can be met even as sowing begins.

The Centre has already initiated measures to directly link maize (corn) farmers with ethanol producers, who will procure the coarse grain at MSP. Such efforts can complement "put options" efforts.

Considering this proposal will not cost the Centre much except the margin that has to be paid upfront to enter trading. Even this will be for a limited period only. Once farmers learn the ropes of derivatives trading, they will choose to go on their own eyeing higher income.

ISSUES TO ADDRESS

However, there are a couple of things that the Government needs to seriously consider. One, it has to end the ban on a slew of agri-commodities derivatives which was imposed from December 2021. If derivatives in agri-commodities trading is to be suspended or banned ad hoc, such policies are not bound to work.

Two, there is a fear such a move could trigger inflation and consumers would be affected. This is something that policymakers have to tackle.

According to experts, one way of testing this could be to try and work this out with basmati rice since the Punjab government has been talking about guaranteeing MSP. Or even one of the State governments that can come forward to help farmers through FPOs.

NCDEX, Nabard and the Maharashtra government were to work out a similar project for turmeric. That seems to have been put in cold storage with turmeric prices soaring on lower production and short supplies.